

FIRST BIENNIAL REPORT

OF THE

State Corporation Department

TO

THE GOVERNOR OF THE STATE OF CALIFORNIA

By

H. L. CARNAHAN

Commissioner of Corporations

1916

LETTER OF TRANSMITTAL

To Hiram W. Johnson,

Governor of California.

I herewith transmit the first biennial report of the State Corporation Department.

Respectfully,

H. L. Carnahan,
Commissioner of Corporations.

October 28, 1916.

REPORT OF STATE CORPORATION DEPARTMENT.

The operation of the Investment Companies Act, or so-called Blue Sky Law, in California has clearly demonstrated the expediency of its passage and the necessity of its continuance. Adopted by the votes of the people for their own protection, the beneficial effects of the law have been so apparent that they have been persuasive even with most of those who, before its passage, sincerely opposed the measure, and the clean business interests of the state, though closely and directly affected by the provisions of the law, have become its staunchest friends.

Not only has it been demonstrated that deception and fraud in the issue of corporate securities can be largely eliminated and legitimate business made more likely of success because of initial examination and subsequent supervision by the state, but that these things can be accomplished at a nominal cost and burden to the state and to the corporations involved.

Expense Not Burdensome.

In the period of 20 months covered by this report—January 1, 1915, when the State Corporation Department commenced its work, to September 1, 1916—2,680 corporations, having an aggregate authorized capital stock of \$869,005,104, made applications to the department. The commissioner signed 4,816 formal orders affecting the issue of securities. He permitted the issue by 1,970 companies of 82,781,439 shares of stock at an authorized selling price of approximately \$246,353,759, and the sale by 93 companies of bonds of the face value of \$59,699,400 at an aggregate minimum selling price of \$57,989,881, an average of about a half million dollars per day (including Sundays and holidays) since the department was organized.

For the same period, the total cost of maintaining the department, including the payment of salaries, initial expense of organization and purchase of furnishings and equipment, also providing for the maintenance of a branch office at Los Angeles, was \$54,998.16. This is less than one-fiftieth of one per cent of the selling price of the securities authorized to be sold, and considerably less than one one-hundredth of one per cent of the authorized capital stock of the corporations making application to the department. It is also less than a one five-hundredth part of the average cost to the corporation of selling the same securities where they are marketed through brokers or agents.

The total receipts of the department in fees from all sources were approximately \$35,000, a tax of a little more than one one-hundredth of one per cent of the selling price of all securities authorized, the remainder of operating expenses being made up from the \$10,000 appropriated by the legislature to put the act into operation and from the general funds of the state. The fees required to be paid to the department to cover the cost of examination and supervision of the issue of securities are insignificant compared with the fees which are required to be paid merely for the service of filing articles of incorporation in this and other states.

California Holds Her Own.

California is the second state in the Union in the number of corporations doing business within its boundaries, sixth in the amount of capital invested in corporate enterprises organized within the state, and also sixth in the amount of corporate earnings, being exceeded only by the states of New York, New Jersey, Massachusetts, Pennsylvania and Illinois.

It is a significant fact, and a sufficient answer to the lugubrious opponents of all forms of business regulation, that with the Blue Sky Law in operation for nearly two years, California has maintained these relative positions in spite of abnormal conditions which have given a tremendous impetus to business in the eastern states, but which have not materially affected the western coast.

The aggregate authorized capital of new corporations, domestic and foreign, filing their articles in California for the year 1915, was substantially in excess of the record for the preceding year before the Blue Sky Law became effective, and the aggregate capitalization of new corporations for the first eight months of 1916 shows a large increase over the corresponding months of 1915.

Honest and legitimate business has not been hampered, and California is well rid of other classes of corporate enterprises which have either voluntarily fled, or have been assisted in their departure to other states where conditions are more to the liking of the Wallingfords of industry.

Sisson's diving bell, designed to lure treasures from the vasty deep and money from the pockets of the unwary, presented to us by the Blue Sky Commissioner of Oregon, has floated eastward from Los Angeles. Berry's airship has flown to other climes where folks are still separated from their money in purely atmospherical ventures. Railless and carless monorail projects hastily concocted in fertile brains and based upon the intensive study of a two-inch paragraph in a scientific magazine; wave motors that solved the problems of power conservation—on paper only; gold machines that swallowed gold instead of yielding it—the countless gold-brick promotions of febrile imagination, especially indigenous to the southern part of the state, have moved on, unwept and unsung, save for the melancholy chorus of their victims.

Beneficial Effects Evident in California.

A comparison of the number of companies promoted in California during the past 20 months, simply for the purpose of unloading cargoes of handsomely engraved and worthless paper on the public and to then dry up and blow away, with the number of like ventures in any similar period preceding, is a fair test of the efficiency of the law. Another fair test is to compare the decrease in promotion frauds in connection with new California companies with the increase of such frauds through companies organized outside of California and whose stock, there issued, is peddled here.

This comparison has been so evident and favorable to the law as to cause general comment among business men in position to observe the change. The occasional cry that business is being hurt comes usually, either from those who do not understand the operation of the law and who have not taken the pains to learn, or from those whose business will not stand inspection. Such criticism frequently furnishes reasonable ground for inquiry as to the safety and integrity of the venture in which the critic may be interested.

Stands for Fair Dealing.

The essence of the Blue Sky Law is the spirit of fair dealing. Its administration does not call for the promulgation of a new code of ethics or business principles. Fraud and misrepresentation in the financing of corporations and the sale of corporate securities, which the law is intended to reach, have always been condemned by honest business and honest men. There is no need to impose onerous burdens upon the financing of clean enterprises or to teach honest business how to be honest in newly discovered ways. The department is working only to the end that corporations generally shall conform to the standard of integrity that has been manifest among the decent corporations of California both before and after the law went into effect.

It is not the purpose of the law that the state shall attempt to remove the ordinary hazards of business or that it shall attempt to limit the right to engage in speculative enterprises as long as they are fairly conceived and honestly conducted. Fairly informed of the hazards, the mentally competent should be allowed to determine for themselves whether they desire to risk their money in any lawful venture.

Flexibility Proves an Advantage.

The necessity of such regulation as will protect the public from fraudulent schemes and unprincipled schemers is fairly evidenced by the demand of the people themselves, which has been so general and insistent that no less than 17 states have adopted Blue Sky laws in various forms. California's law is probably the most flexible in its operation of them all. At the same time it is not subject to the constitutional objections that have been successfully urged against similar legislation in other states.

Largely, perhaps, because most of these laws have sought to place definite and specific limitations upon the discretion of the administrative authority, the general custom elsewhere has been either to unconditionally deny an application or to issue a purely formal permit without imposing restrictions as to the amount or character of securities that may be sold, the commissions that may be paid, the disposition of promotion shares, and other matters vitally affecting the destiny of the corporation and the welfare of the investing public. This must result either in a denial of authority to enterprises that might reasonably be trusted to go forward under proper conditions, thereby injuring those who have already invested, or in the grant of authority without imposing conditions necessary to safeguard both prior and future investors.

In California, with the advantage of a more elastic statute, the department has pursued the practice of placing on the face of permits authorizing the sale of securities to the public, a succinct and accurate recital of the financial condition and purposes of the company, based upon the sworn statement of its officers or upon independent investigation by the state.

The company is then required to deliver a copy of the permit to the prospective purchaser of its securities, so that, although the business may be extremely speculative in character or even hazardous, he is fairly advised of the facts and can exercise his own judgment as to the desirability of the investment.

Where it appears necessary or expedient, such conditions are imposed as will tend to give assurance of the fairness and feasibility of the project, rather than to deny applications and discourage enterprises in which people may desire to invest and which may succeed, even though success seems somewhat improbable.

Constitutionality Not Questioned.

The constitutionality of California's Blue Sky Law has not been attacked. Nor is such an attack, if made, likely to meet with success. To establish the validity of the California statute, it is not necessary to rest it solely upon the police power of the state, as is the case with the statutes of several eastern states that have been successfully assailed in the federal courts. Ample authority for the passage of our law may be found in the power reserved by the state to itself, in the constitution, to impose limitations upon the power of corporations.

The scope of police power, on the other hand, rests in the discretion of the court of ultimate resort and can not be accurately defined until that court has spoken. The decision is dependent upon the opinion of the judges as to the public necessity for such legislation—whether the condition sought to be remedied is affected with such public interest as to justify the remedy proposed.

On account of the judicial criticisms of the statutes of other states, it is doubtful if the scope of the California law should be extended beyond the limits where it can be rested safely upon the reserved powers of the state until the Supreme Court of the United States has decided cases now pending before it involving a definition of the limits of the police power of states to enact and enforce such regulations. And, of course, the law should not be amended at any time so that it will impose upon legitimate business such burdens as to render the attempted cure worse than the existing injury.

The courts which have felt impelled to question the constitutionality of these eastern laws have quite uniformly approved of their purpose. In at least two states where the laws were declared unconstitutional, the attacks against them were led by legitimate business interests, which, while they thoroughly approved of the aims of the statute, objected to features which proved unduly onerous to honest and conservative enterprises.

In this state, the administration of the law has not met with similar objection, and the better business men, realizing that their business will be benefited through the drawing of a line between them and crooked business, have generally supported the department.

Worthless Securities Kept Off Market.

The direct financial benefits, accruing through the elimination of worthless or fraudulent securities from the markets of the state can not be accurately estimated in figures. But a brief survey of the activities of the department may serve to show what has been accomplished.

Few applications to sell securities have been flatly denied. The effort has been rather to persuade corporations to so modify their plans of organization and business as to offer fair conditions to the investor.

Numerous corporations which either did not furnish information essential to a proper determination of their applications or would not or could not conform to reasonable conditions deemed necessary for the protection of the public, have abandoned their plans. Many others whose plans of business, tentatively submitted, have failed to meet with the approval of the department, have refrained from making application.

Of the corporations filing applications, approximately 120, having an aggregate authorized capital of \$53,000,000, and applying for permission to issue securities of the aggregate par value of approximately \$23,000,000, have been denied authority or have abandoned their plans, either failing or refusing to furnish necessary data, or to adopt such modification as would justify affirmative action. Of the 1,970 corporations permitted to offer their securities, the permits of 304 have been subsequently revoked by the commissioner. This action was taken in some cases upon application of the company which had completed its financing, or which for other reasons, desired to withdraw its securities from the market; in others, because of abandonment or failure of the enterprise, and in a number of cases upon discovery that the business was being conducted in such a manner as to imperil the interests of stockholders.

The act provides a method of appeal from any decision of the commissioner. The fact that no appeals have been taken is fair evidence that the action of the commissioner, either in denying or revoking or in imposing conditions upon the right to sell securities, was in each case justified by the circumstances.

Some Examples of Suppression.

The activities of the department have not been confined merely to the elimination of trashy frauds, but have been equally concerned with larger enterprises which have offered conditions even more dangerous to the public because their securities, offered as a conservative investment, upon investigation proved to be something less than a bad speculation.

A dignified San Francisco corporation, installed in an expensive suite of offices, was one of the leading opponents of Blue Sky legislation. Shortly after the law became effective, the reason was apparent. It had sold to more than a thousand purchasers nearly a million dollars worth of unsecured promissory notes and called them bonds. Into the purchase of this paper had gone a lifetime of savings of many old men and women, the bulk of estates left by husbands and fathers to their widows and orphans, the accumulations of those who wanted the safest investment and the surest income. On an examination of the company's application to continue their sales, it was found to be in a hopelessly insolvent condition. Its right to carry others down in the crash which followed was not only denied, but the creditors were assisted in organizing so that they saved for themselves a substantial proportion of their claims that otherwise would have been lost.

Another San Francisco company, operating under the cover of a highly reputable but inattentive board of directors, and conducted by a dishonest manager, who attempted to conceal the loss of its only asset of value, applied for permission to sell stock at a price above par. Investigation revealed the fact that the company did not even have a plan of business left. It had previously unloaded considerable stock on the public. Neither it nor its manager has since been permitted to rob others.

This situation and the action taken found an almost perfect duplicate in Los Angeles.

A Fresno capitalist, selling stock in an alleged banking enterprise, which would never have been able to secure a certificate to do a banking business, quickly suspended operations when the department acted, although jurisdiction was doubtful. The grand jury took up the case and there has been some restitution.

Charles A. Elder, convicted of fraud in the operation of the Los Angeles Investment Company, except for the interference of the department, would be now promoting a similar enterprise.

Liquidation of an insurance company was determined upon when its promoter found the State Corporation and State Insurance departments working in harmony for public protection. The company had intended to continue stock sales, which it could not do except by misrepresentation, as the cost of promotion had exceeded the limit established by law, and it therefore could not be granted a certificate to do an insurance business.

An eastern voting machine concern, which had issued more than two and a half millions in stock for patents and paid out from the money secured from the public more than \$200,000 cash in salaries and commissions and had not yet marketed a single machine, was denied authority to offer that kind of an investment to Californians.

Recitals of such cases might be prolonged indefinitely. They are related only as examples for the purpose of indicating the character of a few of the enterprises with which the department has had to deal and from which it has protected the public.

Facts Condemn Some Enterprises.

It is not infrequently true that a plain recital of facts concerning the plans of a company which do not appear to be practicable or offer a reasonable chance of success, serves practically the same purpose as a denial of authority to sell its securities. For the prospective investor, being fairly informed of the actual facts and not having to rely upon the rhetorical accomplishments of a smooth salesman, shies at the venture.

Some complaint has been heard that such permits make stock selling difficult. If this is true, it but demonstrates that stock selling in the past has been easier because the investor did not know what he was buying and obtained this knowledge only through costly experience.

Money saved from ultrahazardous and impracticable ventures means that more capital is available for enterprises which reasonably promise returns, and legitimate and efficient business is profiting because of the caution of the public.

Problem of "Promotion Stock."

One of the most serious problems with which the department has had to deal is the disposition of so-called "promotion stock." The unrestricted issue of large blocks of stock for little or no tangible consideration gave rise to the most vicious practices. The crooked promoter deliberately organized a corporation for the purpose of grabbing half or more of the stock, misrepresented it to purchasers, who were led to believe that their money was to finance the enterprise, pocketed the proceeds himself, and then proceeded

on his way to the next scheme, rejoicing and jingling. The company was usually left without a business head, without money, and without hope of successful operation.

Not infrequently, too, the organizer who took promotion stock without dishonest intent, was tempted to sell and realize a personal profit as soon as the company had established a selling price for its unissued shares. The almost inevitable outcome was to ruin the company's chance of financing itself and add another carcass to the boneyard of abandoned hopes.

The history of a holding company formed to finance the construction of a railroad out of Stockton is a recent and typical example of this evil. After building a part of the line, holders of promotion stock began advertising their shares for sale at 20 cents, while the company, desperately in need of finances, was trying to sell stock at a dollar per share. Of course, nobody would buy for a dollar stock that could be purchased for one-fifth that amount. Two streaks of rust, ending nowhere in particular, and the loss of a large amount of money, mostly by people who could ill afford to lose, is the result.

Promoter Must Win for Investor.

The inventor who organizes a company upon the possible value of his invention, the prospector who locates a claim which may develop into a profitable mine, the promoter who contributes valuable services or other foundations for business enterprise, which may succeed if properly financed and managed, is justly entitled to a fair reward. There is no disposition to deny it to him, but the department maintains that he is not entitled to "cash in" until he has made good for those who finance the enterprise.

Where stock is permitted to be issued for considerations of intangible value or impossible of fair appraisal, it is usually made a condition that the certificates shall be placed in escrow so that the shares may not be resold except under the supervision of the department. When the company has been financed, is a going concern, and has established a value for its shares so that a purchaser is not likely to be defrauded, the escrow is terminated.

In the 20 months covered by this report, shares of stock having an aggregate par value of \$44,563,000 have been ordered deposited in this manner. A part of it has been released from time to time where such action was not likely to prove injurious to the company or to the public. Some has not been deposited at all, the thought of actually having to work for their reward proving most annoying to certain promoters. In the latter event, the stock is either not issued and the project abandoned, or, if the promotion stock had already been issued before the law went into effect, the company's right to sell treasury stock and inveigle others into a hopeless situation, has been promptly revoked.

To establish any fixed rule as to the amount of stock that should be issued for considerations of indefinite value, has been impossible. But it has generally proved true that the promotion hog can not travel far in California, because, if he is inclined to take a larger share of the enterprise than conservative corporation policy would approve, his porcine qualities are made so evident on the face of the permit that the prospective purchaser fails to respond.

To Make Investment More Attractive.

The department has met with no little success in urging companies where the promoter desires control (and frequently he should have it for the welfare of the enterprise), to create a preferred stock to be sold to the cash investor while the promoter retains his interest in common stock. The man who puts up the money secures a more desirable investment, making the project easier to finance, and the promoter or inventor or miner, as the case may be, profits equally if his business succeeds half as well as he thinks it is going to do when he presents his plan to the department.

Dangers of Insufficient Capital.

One of the principal causes of business failure is lack of sufficient capital. A corporation that needs \$50,000 to carry out its plans or fairly test its project, and is able to raise but \$10,000, is almost invariably headed for the rocks, and the stockholders' money is simply wasted. The financial shore is strewn with such wrecks, although they may have been honestly and even skilfully captained under such adverse conditions.

To avoid this situation, the department, where it seems expedient, frequently provides that subscriptions shall be taken contingent upon raising, within a prescribed period, the full minimum amount required to carry on, or, at the least, reasonably begin the business of the corporation. If the company is unable to raise sufficient funds to meet its minimum needs, the subscriber may rescind his subscription and recover the amount paid in by him, and nobody is injured. If the amount is raised, it immediately becomes available for use and with sufficient capital the business is more likely to succeed.

Organizers of corporations who have real confidence in the success of their plans have welcomed the suggestions of the department as to fair methods of organization and the restrictions placed upon the resale of their shares, because they are finding it easier to interest capital when capital is assured that the promoter is going to work for the company and that the company was not formed for his exclusive benefit.

Regulating Commissions.

Regulation of the amount of commissions that may be paid on the sale of securities has corrected a reprehensible practice to the advantage alike of clean business and the investor. It has seriously disturbed the practice of the buccaneer promoter who voted himself a majority of the corporations' shares for services, and then proceeded to install himself as fiscal agent, not infrequently taking from 40 to 60 cents (and in some cases even more) out of every dollar paid into the company by purchasers of its treasury shares. The burden thus imposed upon the residue of the investment that finally reached the company's treasury was so great that the chances of successful operation and the payment of dividends were extremely remote. Clean business was often forced to compete to secure skilful salesmen, and the cost of financing the better class of corporations also became excessive.

Investigation of one corporation operating in Sacramento developed startling facts, though typical in a lesser degree of many other promotions. This company, if it had been honestly, economically and efficiently promoted and managed, apparently had an opportunity to achieve substantial success. Half a million dollars worth of its stock, however, had been handed out in exchange for an invention. Fiscal agents, who

participated largely in the promotion stock, and who also had the management of the enterprise, had a contract allowing them a 40 per cent commission on stock sales. An examination of their own books showed that they had actually retained more than half of all monies received, and although they owed the company money for commissions withheld, they were loaning it money at interest to pay operating expenses. The value of the outstanding stock, based upon tangible assets, was but a few cents per share. In spite of these facts, application was made to raise the selling price of the company's stock from \$1 to \$2 per share, so that subscribers at the lower price who had not paid in full would be deceived as to the actual worth of the shares, and pay up. The department refused to countenance such practices and stopped a rank stock-selling scheme which was fattening the insiders while the company starved to death.

The department puts a definite limitation upon the expenses of financing enterprises, endeavoring in each case to fix as a maximum the amount that experience has shown should be sufficient to sell securities of like character in similar projects. Except in a few unusual cases, this does not exceed 20 per cent of the gross selling price of the securities and is usually less. In fact, the total commissions authorized to be paid in the sale of stock in the past 20 months amounted to approximately six and a half million dollars, or but two and seven-tenths per cent of the gross selling price of the shares, the average being largely reduced, of course, because a great many companies are financed without any expense for such purposes.

Eliminating the Crooked Salesman.

Through its supervision of agents who must secure certificates before offering for sale the securities of investment companies, the department is weeding out the crooked salesmen who have employed every trick and device short of the use of a blackjack to separate the credulous from their dollars and who frequently deceived even the investor of average prudence.

Outlaw Wildcats Still Operate.

Control over advertising matter concerning the securities sold under the department's supervision has resulted in the elimination of printed promises of impossible returns, fraudulent and deceptive in character and skilfully designed to trap the unwary, with which the state was previously flooded.

The department, however, has no control over the wildcatters operating from the cover of other states, who endeavor to unload their own worthless certificates for personal profit through the medium of cunningly worded advertisements. The only present remedy for this situation is the vigorous enforcement of the penal statute against fraudulent advertising and the insistence upon the part of the people, before even remotely considering an investment, if they would save themselves from almost certain loss, that these outlaws shall obtain a clean bill of health from the Commissioner of Corporations.

The people may safely assume that corporations which find it necessary to evade the provisions of the Blue Sky Law, are not organized for the benefit of the investing public. They may further make up their minds to one of two things—or accept both

conclusions—that the promoters are enjoying the ancient and dishonorable pastime of unloading their own stock for personal profit, or that they have adopted the subterfuge of bringing stock, which has been issued to themselves in another state and is, therefore, not subject to the Blue Sky Law, into this state for resale, because their plan of business is such that they dare not present it to the department for inspection.

The investor in such securities usually can have no assurance, other than the word of the promoter who has evaded a California law framed to protect California investors, that any of his money is going into the enterprise to work for him, and no genuine assurance that he is investing in anything more substantial than a promoter's nightmare.

No Injury to Honest Mining.

Misapprehension as to the attitude of the department and the effect of the operation of the Blue Sky Law on speculative enterprises has largely disappeared. This is true in spite of the zealous efforts of wildcat promoters to foster the impression that the law would prevent the development of such enterprises and particularly of the mining industry. Their zeal is inspired by the fact that the desire to excuse their own departure from the state on some plausible pretext; whereas, the real reason is simply that their schemes will not stand the light of day.

It is true that the Blue Sky Law has largely terminated that character of mining—neither placer, quartz nor dredge—which consists in transferring gold to the pocket of the trickster from that of his victim. But it is equally true that the law encourages the kind of mining that contemplates digging a hole in the ground and finding out what may be there.

Many honest corporate ventures are pure gambles and are known to be so by every stockholder. Though speculative, their business may be as legitimate as that of manufacturing rolled oats. If men want to band themselves together in a corporation to go out into a new and untried field and, with their eyes open, take a chance of discovering oil or paying ore, there is no reason why they have not as much right to do so in this form of organization as they have as individuals.

The department does insist, however, that the company desiring to sell stock in its venture show that it has a place to dig a hole, that the prospect be fairly represented to the purchaser of shares, and that his money shall go into the process of development. The policy is rather disturbing to the professional wildcatter, but makes for honest mining. The fact that 312 mining and oil companies, having an aggregate authorized capital stock of \$314,262,300, have been authorized to issue \$78,580,500 of their securities, is fairly indicative that legitimate mining enterprises have been encouraged.

Adding Safety to Investment.

Where corporate securities offered for sale are represented to be, and in the eyes of the public approach a conservative investment, the department insists that they shall be of that character. Before permitting the sale of bonds, notes, or other definite promises to pay, it must appear that there is a sufficient present security and a reasonable probability that the company issuing them will be able to meet interest payments when due and to repay the principal amount at maturity. Where the purchaser of such securities faces any unusual risk, the company is required to fully advise him of the facts. The wisdom of this

policy will be evidenced by the lessening number of foreclosures, and is already apparent in the growing public confidence in this class of securities.

Bureau of Information for Investors.

Every investor in corporate enterprises under the supervision of the department now has a place to which he may appeal for impartial, disinterested and authoritative information regarding the affairs of the company in which he is interested. The extent to which many corporations have been careless of their obligations to small investors is illustrated by thousands of inquiries received by the department from stockholders who have been unable to secure satisfactory information from the companies in which they have invested their earnings and are either ignorant of their legal rights or have not sufficient at stake to justify the expense of an independent investigation.

Although it has no power to conduct examinations, except of such companies as are within its jurisdiction, the department is endeavoring to secure information as to the standing of all enterprises concerning which inquiry is made, and is becoming a general clearing house of information regarding corporate securities generally.

In one case, a widow contemplating the exchange of a country hotel property for 6,000 shares of stock in a refrigerating company that she was assured had always sold for a dollar a share, was saved from loss or a lawsuit by use of the long distance telephone. Investigation by the department, at her request, developed the fact that the company had expired some few years previously and the stock was worth only the current price of bond paper after it has been soiled with printer's ink and sealed with gold wafers.

Public Cooperation Necessary.

To aid the department in detecting and preventing fraud, the people of California are urged to cooperate closely in the administration of the law. The commissioner should be advised of every misrepresentation made in the sale or attempted sale of securities, past or present, so that prompt action may be taken to correct irregularities, and that swindlers may be properly catalogued and denied participation in further enterprises.

Many victims of fraud are disinclined to complain, because they consider their misfortune a reflection upon their business capacity and prefer to accept loss in silence rather than to expose themselves to possible ridicule. It is the duty of all good citizens, however, to protect others from like experiences, and only through the accumulation of such information will the state be able to most effectively carry out the purposes of the law.

While the discovery of crooks is essential to the successful operation of the law, it is but incidental to the other work done in its administration. The department also recognizes that the right kind of promotion and management is one of the most valuable elements in corporate success. An established reputation for ability and integrity is considered in the department, as in any bank, an asset that frequently possesses value measureable in actual dollars, and is always persuasive of honesty of purpose.

Caveat Emptor.

The fact that actual fraud may be largely eliminated and the public protected to some extent against incompetency and bad business methods, does not mean that the prospective investor in corporate securities, the sale of which has been permitted by the state, should not carefully investigate and satisfy himself as to the character of the securities offered him and the standing and ability of the management of the enterprise.

Less than 10 per cent of corporations formed during the entire history of the state have regularly paid dividends from surplus profits earned by them. The same is true of other states, and it is probable that the proportion of failures in corporate business is not greatly in excess of other forms.

The department does not, and manifestly can not, determine for the public whether a business will certainly be successful. It has no control, nor should it have, over the prices that may be charged for products or over competition in any field of industry. Neither can the state guarantee human efficiency.

Speculative enterprises may fail to realize anticipations although honestly and skilfully managed. Business of all kinds will continue to fail through poor management, want of sufficient capital, lack of opportunity, or any of the hundred and one hazards with which almost every venture is surrounded.

The endeavor of the department is to see to it that corporations offering their securities to the public are honestly organized, have a reasonable business plan, are decently managed, and that the prospective investor is fairly advised of the material facts relating to the enterprise to which his subscription is solicited.

Department Aids Corporations.

The department's work is not confined alone to the protection of the investor. It is a bureau of service to the corporation, as well as to the public, and is daily exerting its influence to aid corporate business to proceed along practical lines and to avoid the abnormalities of organization and promotion that experience has proved to be impractical or destructive.

The knowledge that the department has gained of the more successful forms of business organization is available to those who desire guidance and wish to proceed in a manner most likely to accomplish their aims. Advantage of this fact is being taken by corporations and those interested in them, in a constantly increasing measure. Uniformity of organization along better business lines should not only mean a brighter prospect for success, but should naturally inspire in the public a greater confidence in legitimate ventures and render it easier and less expensive to finance clean enterprises.

The department has endeavored at all times to give authority promptly to all ventures honestly promoted or operated, and in doing this to make the burden of compliance with the act as little onerous as possible. Technicalities of procedure have been eliminated as far as is consistent with a proper determination of the merits of the company applying for authority. Formal hearings have been almost entirely dispensed with in the interest of dispatch, and examinations have been conducted at the expense of companies only where no other form of investigation would elicit the necessary facts.

The purpose and intent of the Blue Sky Law are universally commended. It is hoped that its administration thus far has served to justify its enactment. The consensus of business opinion seems persuasive of the conclusion that the State Corporation

Department has established itself as a useful and efficient branch of the government. Its endeavor will be to continually extend its field of usefulness to the state and to all of the citizens of California.